No. [redacted] 17

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1968

UNITED STATES OF AMERICA,
Petitioner,

v.

THE DONRUSS COMPANY,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The District Court did not render an opinion. The opinion of the Court of Appeals is reported at 384 F.2d 292.

JURISDICTION

The judgment of the Court of Appeals was entered on September 27, 1967. (Pet. App. 22-23). The petition for a writ of certiorari was filed on December 26, 1967. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Whether, in order to prevent the application of the penalty imposed by Section 531 of the Internal Revenue Code of 1954 where the taxpayer has accumulated funds beyond the objectively definite and certain needs of its business, taxpayer must demonstrate that no consideration was given to the tax consequences of the accumulation of its earnings; or if consideration was so given, that any distribution would not result in taxable income to taxpayer's shareholders.

STATUTE INVOLVED

Sections 531, 532 and 533 of the Internal Revenue Code of 1954 are printed in the Petition, pp. 2-3.

STATEMENT

The facts are set forth in the opinion of the Court of Appeals, 384 F.2d 292, and, as pertinent hereto, are as follows:

The Commissioner of Internal Revenue assessed and collected from respondent, The Donruss Company (hereinafter referred to as "Donruss"), accumulated earnings taxes for the taxable years 1960 and 1961. Thereafter, Donruss brought an action for the refund of said taxes in the United States District Court for the Western District of Tennessee. On the basis of the jury's response to special interrogatories, the District Court entered judgment for Donruss. The United States appealed to the United States Court of Appeals for the Sixth Circuit which reversed on the ground that the District Court erred in failing to explain the significance of the word "the" when it instructed the jury that avoidance of taxes on the corporation's shareholder had to be "the purpose" of the accumulations. Rejecting petitioner's contention that the jury should be instructed that tax avoidance need only be "one of the purposes" for the company's accumulation policy, the Court of Appeals held that on remand the jury should be instructed that the accumulated earnings tax applies only if tax avoidance was the "dominant,

controlling or impelling motive" behind an excessive accumulation of earnings.

ARGUMENT

The decision below is correct, and there is no conflict or any other reason for further review.

1. Although the ruling below and the previous decisions of the United States Court of Appeals for the First Circuit, *Young Motor Co. v. Commissioner*, 339 F.2d 481 (1st Cir. 1964); *Commissioner v. Young Motor Co.*, 316 F.2d 267 (1st Cir. 1963); *Young Motor Co. v. Commissioner*, 281 F.2d 488 (1st Cir. 1960), might appear to conflict with the opinions expressed by the Second, Fifth, Eighth and Tenth Circuits,[1] a careful reading of the cases cited by petitioner leads inescapably to the conclusion that in fact there is no clear conflict of reasoned authority. In none of these cases will the Court find a studied analysis of the phrase "the purpose" appearing in Section 532(a) of the Internal Revenue Code of 1954. The Eighth Circuit merely cites with approval opinions of the Second Circuit in *Trico Products* and the Tenth Circuit in *World Publishing Co.* Furthermore the issue of taxpayer's burden of proof as it relates to the tax avoidance motive was not clearly before the court on the facts, and this issue was neither raised before, nor considered by, the court below. See *Kerr-Cochran, Inc.*, 14 CCH Tax Ct. Mem. 304 (1955). Similarly, the Tenth Circuit in *World Publishing Co.* states, without citation or analysis, that for the penalty tax to apply, tax avoidance need not be the sole purpose if it is a "determining factor." Apparently, no argument was made that it need be the "dominant, controlling, or impelling" motive. Again, the Tenth Circuit's enunciation of the rule is clearly *obiter*.

[1] *Barrow Mfg. Co. v. Commissioner*, 294 F.2d 79 (5th Cir. 1961), *cert. denied*, 369 U.S. 817 (1962); *Kerr-Cochran, Inc. v. Commissioner*, 253 F.2d 121 (8th Cir. 1958); *World Publishing Co. v. United States*, 169 F.2d 186 (10th Cir. 1948), *cert. denied*, 335 U.S. 911 (1949); *Trico Products Corp. v. Commissioner*, 137 F.2d 424 (2d Cir.), *cert. denied*, 329 U.S. 799 (1943).

In *Trico Products Corp.*, the Board of Tax Appeals held that taxpayer must carry the burden of proving the complete absence of a tax avoidance motive. See *Trico Products Corp.*, 46 B.T.A. 346, 374 (1942). The Second Circuit affirmed without analysis. In fact, the only analytical attempt to justify petitioner's position herein was made by the Fifth Circuit in *Barrow Mfg. Co. v. Commissioner, supra.* Although the issue had not been ventilated before the Tax Court, see *Barrow Mfg. Co.*, 19 CCH Tax Ct. Mem. 195 (1960), the Fifth Circuit reasoned that the utility of the presumption arising from the accumulation of earnings beyond the objectively reasonable needs of the business would be destroyed if "saddled with requirement of proof of 'the primary or dominant purpose' of the accumulation." 294 F.2d at 82. This analysis completely misconstrues the statute because in addition to the presumption of correctness in favor of the Government, Section 533(a) provides that the fact that earnings and profits are permitted to accumulate beyond the objectively definite and certain needs of the business is determinative that the "dominant, controlling or impelling" motive of such accumulation was for the forbidden purpose to avoid shareholder taxes unless the taxpayer corporation proves by a preponderance of evidence that tax avoidance was not the "dominant, controlling, or impelling" motive. Thus, taxpayer must convince the trier of fact either that tax considerations were not involved at all; that there were other equal motivating factors; or that some other consideration controlled. The presumption is not compromised, only the quantum of proof is affected.

Because the only considered analysis of the subject phrase "the purpose" is to be found in the Sixth Circuit's opinion in the instant case, and in the opinions of the First Circuit in *Young Motor Co.*, there has been no thorough and considered debate among the circuits to bring the issue into sharp resolution for determination by this Court. Thus, there is no "real and embarrassing conflict of opinion and authority between the circuit courts of appeal." *Layne & Bowler Corp. v. Western Well Works*, 261 U.S. 387, 393 (1923) (Taft, C. J.).

2. The decision below constitutes the only reasonable construction of Section 532(a). The view of the Second, Fifth, Eighth and Tenth Circuits is ill considered and oblivious to practical reality. Section 532(a) does not provide for imposition of the penalty tax of Section 531 if tax avoidance is "a purpose" of the accumulation; "one of the purposes" of the accumulation; or even "a major purpose" of the accumulation, *cf.* INT. REV. CODE OF 1954 § 1551. The statute provides that the penalty tax shall apply if the corporation was "formed or availed of for "the purpose" of tax avoidance. This Congressional directive is clear and unambiguous. Its plain meaning is as stated by the First and Sixth Circuits: taxpayer must convince the trier of fact, not that no consideration was given to the tax consequences of the accumulation, but that the avoidance of tax was not the dominant, controlling, or impelling motive of its failure to declare a dividend.

It is submitted that the test urged by petitioner would be productive of chaos in this area of the tax law. Under this test, a corporation would be subject to the tax on retained earnings determined by the trier of fact not to be objectively necessary for the specific and definite needs of its business, see Treas. Regs. § 1.537 (1959), in every case where tax considerations entered into its determination to retain its earnings, notwithstanding the fact that taxpayer could demonstrate other valid, if not sufficiently definite and certain, reasons for the retention of earnings; and notwithstanding the fact that it would not have declared a dividend to its shareholders in any event. An officer or director of a closely held corporation may be presumed to know the tax consequences of a distribution to shareholders and such knowledge may in many circumstances determine the course of action which the corporation follows. However, to assume that mere knowledge of the tax consequences of a corporate distribution automatically triggers the application of Section 531 in all situations where funds have been retained in excess of the objectively definite and certain needs of the business, totally vitiates the requirement of Section 532(a)

that "the purpose" of the accumulation be tax avoidance. Nevertheless, under the test espoused by petitioner the question of motivation would, as a practical matter, turn upon knowledge. Under this test the only corporation which could overcome the presumption of Section 533(a) would be a corporation of which the controlling shareholders would not be subject to tax as a result of a corporate distribution.

Petitioner complains that the Sixth Circuit has emasculated the presumption of Section 533(a) and undermined the purpose of the Section 531 tax. It cites *Helvering v. Chicago Stock Yards Co.*, 318 U.S. 693 (1943) for the proposition that the purpose of the tax is to compel the distribution of unneeded earnings so as to prevent the avoidance of high rates of tax on the shareholders. With this there can be no quarrel. However, the Congressional purpose is not thwarted, and the statute is not deprived of its teeth, by relieving taxpayer of an impossible burden of proof and saddling him instead with what is certainly a very onerous one. Contrary to its claim, it is petitioner which is undermining Section 531 by writing the "purpose" test out of this section. Under petitioner's interpretation of Section 531 consideration is limited solely to a determination of "the reasonable needs of the business." This error is compounded by the government's aggressive attempt to limit the scope and extent of a taxpayer's business needs solely to liabilities appearing on its balance sheet and cash necessary to satisfy written commitments.

It is submitted that because the statutory language is clear and unambiguous and because to accord this clear statutory mandate its plain meaning not only does not violate the statutory scheme but, in fact, is wholly consistent therewith, the decision below is correct. *Malat v. Riddell*, 383 U.S. 569 (1966).

3. Respondent is not in a position to test the accuracy of petitioner's impressive statistical array as to the frequency with which the penalty tax of Section 531 is applied. Clearly, however, this presentation falls wide of the mark.

Petitioner does not indicate in how many of these cases the precise issue involved herein appears. The reports contain few similar cases. Since 1913, less than ten cases in the courts of appeal have discussed the question and in less than half of these has the issue been squarely presented. The issue could thus hardly be categorized as of sufficient moment to justify the consideration of this Court.

This lack of moment is all the more obvious when one considers that under the 1954 Code, the question of "the purpose" of tax avoidance only comes into play if taxpayer cannot establish definite and certain business needs, including reasonably anticipated business needs, for the accumulation. See INT. REV. CODE OF 1954 §§ 533(a), 535(c), 537. Although tax avoidance is the ultimate statutory issue, as a practical matter, the most frequently contested question is whether the corporation's earnings have accumulated "beyond the reasonable needs of the business." The fact that so few taxpayers have availed themselves of the chance to prove that the accumulation was not motivated by tax considerations clearly demonstrates the extreme difficulty of satisfying the "purpose" test. See B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS, 219-20, 233 (2d ed. 1966). Thus, only two cases involving the "purpose" test have reached the courts of appeal under the 1954 Code, the instant matter and the subsequent case of *The Shaw Walker Co. v. Commissioner*, 68-1 U.S. Tax Cas. ¶ 9211 (6th Cir. 1968) in which the Sixth Circuit reaffirmed its position.

CONCLUSION

The petition for a writ of certiorari should be denied.

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April, 1968.